

Clear Creek Mutual Telephone Company

Financial Statements

Years Ended December 31, 2016 and 2015



CLEAR CREEK MUTUAL TELEPHONE COMPANY

Financial Statements

Years Ended December 31, 2016 and 2015

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Clear Creek Mutual Telephone Company
Oregon City, Oregon

We have audited the accompanying financial statements of Clear Creek Mutual Telephone Company, an Oregon cooperative corporation, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of operations, changes in members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Clear Creek Mutual Telephone Company, as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Aldrich CPAs + Advisors LLP

Salem, Oregon
March 6, 2017

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Balance Sheets

December 31, 2016 and 2015

ASSETS	2016	2015
Current Assets:		
Cash	\$ 659,224	\$ 482,621
Accounts receivable, net of allowance for doubtful accounts of \$2,000 as of December 31, 2016 and 2015	458,618	443,474
Materials and supplies	48,098	50,524
Prepaid expenses	37,778	43,737
Total Current Assets	1,203,718	1,020,356
Other Assets and Investments:		
Investments	379,605	393,255
Other assets	56,772	60,937
Total Other Assets and Investments	436,377	454,192
Property, Plant, and Equipment:		
Telephone	13,843,229	13,746,688
Cable television	9,358,144	9,472,023
Non-regulated property	33,740	33,740
	23,235,113	23,252,451
Less accumulated depreciation	(18,714,193)	(18,325,121)
Property, Plant, and Equipment, net	4,520,920	4,927,330
	\$ 6,161,015	\$ 6,401,878

LIABILITIES AND MEMBERS' EQUITY	<u>2016</u>	<u>2015</u>
Current Liabilities:		
Current portion of long-term debt	\$ 250,000	\$ 250,000
Accounts payable	185,966	183,789
Customer deposits	12,631	16,381
Accrued expenses	268,300	243,876
Advance billings	<u>331,570</u>	<u>269,996</u>
Total Current Liabilities	1,048,467	964,042
Long-Term Debt, net of current portion	<u>2,035,114</u>	<u>2,285,114</u>
Total Liabilities	3,083,581	3,249,156
Members' Equity	<u>3,077,434</u>	<u>3,152,722</u>
	<u>\$ 6,161,015</u>	<u>\$ 6,401,878</u>

CLEAR CREEK MUTUAL TELEPHONE COMPANY**Statements of Operations**

Years Ended December 31, 2016 and 2015

	2016	2015
Operating Revenue:		
Local network	\$ 813,365	\$ 863,282
Network access	1,312,828	1,434,240
Cable television	2,581,674	2,511,228
Miscellaneous	138,396	148,844
Total Operating Revenue	4,846,263	4,957,594
Operating Expenses:		
Plant specific	509,294	482,319
Plant nonspecific	447,608	442,207
Customer	341,830	333,133
Corporate	951,399	945,566
Cable television	2,194,315	2,184,923
Depreciation	298,734	484,646
Other operating taxes	46,633	61,224
Total Operating Expenses	4,789,813	4,934,018
Operating Income	56,450	23,576
Other Income (Expense):		
Other income	156,860	-
Interest and dividends	33,429	41,252
Nonregulated operations, net	(222,893)	(171,021)
Total Other Expense	(32,604)	(129,769)
Income (Loss) Before Fixed Charges	23,846	(106,193)
Fixed Charges - Interest on Long-Term Debt	79,487	93,206
Net Loss	\$ (55,641)	\$ (199,399)

See accompanying notes to financial statements.

CLEAR CREEK MUTUAL TELEPHONE COMPANY**Statements of Changes in Members' Equity**

Years Ended December 31, 2016 and 2015

	Patronage Capital	Other Equity	Total Members' Equity
Balance, December 31, 2014	\$ 2,695,125	\$ 676,718	\$ 3,371,843
2015 net loss	(199,399)	-	(199,399)
Change in memberships	-	278	278
Redemption of patronage capital	<u>(20,000)</u>	<u>-</u>	<u>(20,000)</u>
Balance, December 31, 2015	2,475,726	676,996	3,152,722
2016 net loss	(55,641)	-	(55,641)
Change in memberships	-	274	274
Redemption of patronage capital	<u>(19,921)</u>	<u>-</u>	<u>(19,921)</u>
Balance, December 31, 2016	<u>\$ 2,400,164</u>	<u>\$ 677,270</u>	<u>\$ 3,077,434</u>

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Statements of Cash Flows

Years Ended December 31, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities:		
Net loss	\$ (55,641)	\$ (199,399)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Noncash patronage	(6,714)	(9,767)
Depreciation	298,734	487,463
Depreciation - cable television	416,762	466,456
Changes in operating assets and liabilities:		
Accounts receivable	(15,144)	28,742
Materials and supplies	2,426	(1,261)
Prepaid expenses	5,959	(10,366)
Other assets	4,165	(1,182)
Accounts payable	2,177	(32,666)
Customer deposits	(3,750)	35
Accrued expenses	24,424	8,968
Advance billings	61,574	14,560
Net Cash Provided by Operating Activities	734,972	751,583
Cash Flows from Investing Activities:		
Capital expenditures	(309,086)	(196,572)
Proceeds from investments	20,364	-
Net Cash Used by Investing Activities	(288,722)	(196,572)
Cash Flows from Financing Activities:		
Payments on long-term debt	(250,000)	(398,214)
Change in memberships	274	278
Patronage capital paid	(19,921)	(20,000)
Net Cash Used by Financing Activities	(269,647)	(417,936)
Net Increase in Cash	176,603	137,075
Cash, beginning	482,621	345,546
Cash, ending	\$ 659,224	\$ 482,621
Cash Paid for Interest	\$ 90,640	\$ 110,061

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Notes to Financial Statements

Years Ended December 31, 2016 and 2015

Note 1 - Organization and Summary of Significant Accounting Policies

Organization

Clear Creek Mutual Telephone Company (the Company) is an Oregon cooperative corporation providing telecommunications service to its members on a cooperative basis. The service area is in the general vicinity of Oregon City, Oregon. The Company also provides cable television services through Clear Creek TeleVision, and provides retail and wholesale security and home automation services through ClearView, both of which are operating divisions of the Company.

Basis of Accounting

The Company's financial statements are prepared on the accrual basis of accounting in conformity with the accounting principles generally accepted in the United States of America applicable to regulated enterprises.

Regulation

The Company is subject to limited regulation by the Public Utility Commission of Oregon (PUC) and the Federal Communications Commission (FCC). The Company maintains its accounting records in accordance with the Uniform System of Accounts, as prescribed by the FCC, and adopted by the PUC. As a result, the application of accounting principles generally accepted in the United States of America by the Company differs in certain respects from the application by nonregulated businesses. Such differences primarily concern the time at which certain items enter into the determination of net margin.

Regulatory and legislative actions, as well as future regulations, could have a significant impact on the Company's future operations and financial condition. See Note 1, National Broadband Plan and FCC Order.

Revenue Recognition

The Company recognizes revenues when earned regardless of the period in which they are billed.

Monthly service fees derived from local telephone service, internet and cable television are billed in advance. Advance billings are recorded as a liability and subsequently transferred to income in the period earned. Access charges (see Note 1, Network Access Revenue), long distance and other revenues based on usage are billed in arrears.

The Company recognizes revenue from sales of equipment and accessories at the time of sale. Discounts provided to customers at the time of sale are recognized as a reduction in sales as the products are sold.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable, and notes payable. The Company estimates that the fair value of all of these non-derivative financial instruments at December 31, 2016 and 2015 does not differ materially from the aggregate carrying value of its financial instruments recorded in the accompanying balance sheets.

Estimates

The Company uses estimates and assumptions in preparing financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Cash

The Company maintains its cash in bank deposit accounts that at times may exceed federally insured limits, which is generally \$250,000 per account holder per bank. At December 31, 2016 the Company has \$467,003 of uninsured cash (\$255,869 at December 31, 2015).

The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash.

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Notes to Financial Statements

Years Ended December 31, 2016 and 2015

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Income Taxes

The Company has been granted an exemption from Federal income taxes, except for "unrelated" business income, under Section 501(c)(12) of the Internal Revenue Code. The Company is also exempt from state income taxes. However, in any year for which greater than 15% of gross revenue is derived from nonmember services, the Company becomes a taxable company. The Company was exempt from income taxes in 2016 and 2015.

The Company follows accounting standards generally accepted in the United States of America related to the recognition of uncertain tax positions. The Company recognizes accrued interest and penalties associated with uncertain tax positions as part of the income tax provision, when applicable. There were no amounts accrued in the financial statements related to uncertain tax positions in 2016 or 2015.

Materials and Supplies

Materials and supplies are stated at the lower of average cost or market.

Property, Plant, and Equipment

Telephone plant in service and under construction is stated at cost, including appropriate direct and indirect costs associated with construction. Depreciation is calculated on a straight-line basis over the estimated useful life of the classes of property and equipment in accordance with rates consistent with industry standards. Depreciation rates range from 2.0% to 15%. Costs of plant retired are eliminated from telephone plant accounts and such costs plus removal expenses, less salvage, are charged to accumulated depreciation, in accordance with industry practice.

Cable television property and equipment in service and under construction is stated at cost. Depreciation is calculated on the straight-line basis over the estimated useful life of the classes of equipment. Depreciation rates range from 4% to 20%. Maintenance, repairs, and replacements are charged to expense as incurred. When property or equipment is sold or otherwise disposed of, the asset account and the related accumulated depreciation accounts are relieved, and any gain or loss is included in operations.

Members' Equity

The Company is a cooperative in which most subscribers are members. A \$2 membership fee is charged to each subscriber who becomes a member. The membership fee is nonrefundable and is included in other equity in the statements of changes in members' equity.

Patronage capital is derived from operating margins, which are allocated as credits to the accounts of individual patrons and are subject to retirement at the discretion of the Board of Directors. Other equity is derived from certain nonoperating margins consisting of other income and expense which are retained at the discretion of the Board of Directors in accordance with the Company's bylaws. Losses sustained by the Company may be allocated to the accounts of individual patrons or offset to other equity at the discretion of the Board of Directors in accordance with the Company's bylaws.

Accounts Receivable

The Company generally does not require collateral or other security to support accounts receivable. Receivables are written off when the Company determines an account is uncollectible. Past due status is determined based on the age of the past due account. Credit risk associated with receivables is periodically reviewed by management and, if required, an allowance for doubtful accounts is established based on past credit collections history.

Network Access Revenues

Network access revenue is received under a system of access charges. Access charges represent a methodology by which local telephone companies, including the Company, charge the long-distance carrier for access and interconnection to local facilities. The Company has elected to file access tariffs through the National Exchange Carriers Association (NECA) and directly with the PUC for these charges. These access tariffs are subject to approval by the FCC for interstate charges and the PUC for intrastate charges.

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Notes to Financial Statements

Years Ended December 31, 2016 and 2015

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Network Access Revenues, continued

When network access revenues have been received pursuant to the settlement and access agreements above, they are then either placed into a common pooling arrangement with other exchange carriers for redistribution or kept by the Company. The redistributions are made according to formulas established by the governing boards of the pools and are generally based upon expenses incurred and investments maintained.

The Company participates in various pooling arrangements with NECA.

Settlement, access, and pool distribution revenues are recorded when the amounts become determinable. Related expenses are recorded when incurred. Subsequent true-ups and retroactive adjustments, which are generally allowed for a period of 24 months after the close of the related calendar year, are recorded in the year in which such adjustments become determinable, based upon studies prepared by outside consultants.

In addition to recoveries from the pools, the Company also receives revenues from the Universal Service High Cost Loop Fund (HCL) and other support mechanisms administered by the Universal Service Administrative Company (USAC). These universal service support revenues are intended to compensate the Company for the high cost of providing service in rural areas. The amount of support received from HCL is based on the number of customers served and the cost of providing service in that area being in excess of the national average cost per loop, as determined by the FCC. See National Broadband Plan and FCC Order below for reforms to these support mechanisms. These support revenues are included in network access revenues in the accompanying financial statements. In 2016, the Company received \$121,853 (\$153,599 in 2015) from the USAC High Cost Loop Fund and \$401,668 (\$366,885 in 2015) in interstate access revenues administered through the NECA Pool.

The Company also receives funding from state universal service funds. In 2016, the Company received \$233,035 from the Oregon Universal Service Fund (OUSF) (\$229,303 in 2015). The current funding levels for the OUSF are determined in accordance with PUC Order 13-162 which ended June 30, 2016. In March 2016 the PUC issued order 16-093 related to OUSF. The order is for a 5 year term beginning January 1, 2017 and calls for annual reductions to the OUSF that will result in an overall reduction of not less than 15.2% over the 5 year term for rural companies. In addition rural companies will be subject to a re-allocation process over the term of the order but no company can have its support reduced by more than 20% over this period as a result of this process. The full impact of the order cannot be determined at this time.

National Broadband Plan and FCC Order

In 2010 the FCC issued the National Broadband Plan which outlined a long-term plan to increase broadband penetration rates and services throughout the United States of America.

In 2011, as an initial response to the plan, the FCC approved Report and Order 11-161 (the Order), that began the process of reforming the universal service and Intercarrier Compensation (ICC) systems and adopts support for broadband-capable networks as an express universal service principle. The Order further created the Connect America Fund (CAF) which will ultimately replace all existing high-cost support mechanisms and help facilitate ICC reforms.

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Notes to Financial Statements

Years Ended December 31, 2016 and 2015

Note 1 - Organization and Summary of Significant Accounting Policies, continued

National Broadband Plan and FCC Order, continued

The key provisions of the Order include capping the federal universal service fund (USF), placing limitations on capital and operating expenditures (subsequently eliminated in 2014 by an Order for Reconsideration issued by the FCC), establishing local rate benchmarks, capping monthly USF at \$250 per line, 5% annual reduction of local switching support to be replaced by the CAF to recover costs of switching services, a 9 year transition from the previous ICC system to bill and keep, and adoption of the Access Recovery Charge (ARC) to mitigate impacts of reduced ICC revenues. Implementation of this transition began July 1, 2012.

In 2016, the FCC issued Order 16-33, which provided the option for a voluntary election by rate-of-return carriers to receive model-based support under the Alternative Connect America Cost Model (A-CAM). On November 1, 2016, the Company did not elect to receive model based support under A-CAM. Carriers not electing A-CAM will continue to receive support based on their costs, however these legacy support mechanisms will be modified by Order 16-33. The main changes for carriers remaining on legacy support are as follows:

- Interstate Common Line Support (ICLS) will be transitioned to the CAF – Broadband Line Support (CAF-BLS), which will now provide support for voice and voice – data lines, as well as broadband only lines. Additionally, the fund for CAF-BLS will be limited to \$2 billion.
- The prescribed rate of return will be reduced by 0.25% annually starting July 1, 2016, effectively reducing the rate of return from 11.25% to 9.75% over 5 years.
- Carriers will have broadband deployment obligations based on their current availability of 10/1 mbps broadband service in applicable study areas.
- Support will be phased out in census blocks with 85% or more of competitive overlap by unsubsidized competitors offering 10/1 mbps broadband. Lost support will be phased out over 3 to 6 years depending on the severity of lost support.
- Regression calculations will be used to limit capital and operating expenditures on a prospective basis.

The Company continues to monitor various effects and requirements of the Orders noted above. As of December 31, 2016 the Company meets the local rate benchmark requirements of the Order and is not subject to the \$250 per line support cap. Furthermore, for the period ended December 31, 2016 the impacts to the Company related to the 5% annual decline in switched access revenues, and the .25% reduction of the prescribed rate of return have not been significant.

The overall reform process will continue to take place in phases and will take several more years to implement. Furthermore, it is anticipated that the FCC will continue to issue Further Notices of Proposed Rulemaking and/or Orders for Reconsideration and continue to seek comments on various items. As a result, the ultimate outcome of these proceedings and their impact is uncertain at this time.

Subsequent Events

The Company has evaluated subsequent events through March 6, 2017, which is the date the financial statements were available to be issued.

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Notes to Financial Statements

Years Ended December 31, 2016 and 2015

Note 2 - Investments

Investments are recorded at cost and consist of the following at December 31:

	2016	2015
Rural Telephone Finance Corporation (RTFC)	\$ 18,388	\$ 18,388
National Rural Telecommunications Cooperative (NRTC)	1,915	1,915
Western Independent Networks (WIN)	10,915	10,915
CoBank	299,429	313,079
Oregon Cable Group	48,958	48,958
	<u>\$ 379,605</u>	<u>\$ 393,255</u>

CoBank is a cooperative bank. Borrowers are required to invest a minimum of \$1,000 or 2% of their loan, whichever is less. Patronage dividends are paid annually in cash and in stock.

Note 3 - Other Assets

Other assets consist of the following at December 31:

	2016	2015
Life insurance - cash surrender value	\$ 56,772	\$ 55,637
Service deposits	-	5,300
	<u>\$ 56,772</u>	<u>\$ 60,937</u>

Note 4 - Property, Plant, and Equipment

Listed below are the major classes of property, plant, and equipment at December 31:

	2016	2015
<i>Telephone:</i>		
Land & support	\$ 2,630,810	\$ 2,646,618
Central office	3,818,701	3,824,799
Cable & wire	7,393,718	7,275,271
	<u>\$ 13,843,229</u>	<u>\$ 13,746,688</u>
<i>CATV:</i>		
Vehicles & other	\$ 812,550	\$ 896,667
Head-end	1,897,961	2,016,902
Distribution facilities	6,344,730	6,287,252
Internet equipment	302,903	271,202
	<u>\$ 9,358,144</u>	<u>\$ 9,472,023</u>
<i>Nonregulated:</i>		
VoIP	<u>\$ 33,740</u>	<u>\$ 33,740</u>

CLEAR CREEK MUTUAL TELEPHONE COMPANY

Notes to Financial Statements

Years Ended December 31, 2016 and 2015

Note 5 - Long-Term Debt

Long-term debt consists of the following at December 31:

	<u>2016</u>	<u>2015</u>
Notes payable to CoBank, payable in quarterly principal payments of \$62,500, plus interest of 3.52% at December 31, 2016 (3.18% at December 31, 2015), collateralized by all real and personal property, due in 2022.	\$ 2,285,114	\$ 2,535,114
Less current portion	<u>250,000</u>	<u>250,000</u>
	<u>\$ 2,035,114</u>	<u>\$ 2,285,114</u>

Future maturities of long-term debt are as follows:

2017	\$ 250,000
2018	250,000
2019	250,000
2020	250,000
2021	250,000
Thereafter	<u>1,035,114</u>
	<u>\$ 2,285,114</u>

The debt agreement contains certain debt covenants that require the Company to maintain specific ratios of financial leverage and debt service coverage. At December 31, 2016 management of the Company believes it is in compliance with these covenants.

Note 6 - Employee Benefits

The Company has a noncontributory profit sharing plan covering all eligible employees. Employees are eligible to participate in the plan on the first day of the month following 1 year of service with the Company in which 1,000 or more hours are worked. Contributions to the profit sharing plan, including amounts charged to construction for the year ended December 31, 2016 were \$115,319 (\$108,316 in 2015).

The Company has a 401(k) retirement plan, under which the Company contributes 1% of all employees' eligible compensation to the plan and will match up to another 2% if the employee contributes 2%. Total Company contributions for the year ended December 31, 2016 was \$38,421 (\$34,073 in 2015).